

CHAPTER 12

Contract Law

MARGARIDA LIMA REGO
CARLOS FERREIRA DE ALMEIDA

SUMMARY: 1. *Legal sources* 2. *Concept and general principles* 3. *Form and formation* 4. *Representation* 5. *Validity* 6. *Contents and effects* 7. *Performance, non-performance and remedies* 8. *Continuity and change*

1. Legal sources

The most important legislative source of Portuguese general contract law is the Civil Code of 1966. To a large extent, this Code was modelled upon the German *Bürgerliche Gesetzbuch (BGB)*. In fact, its main structure follows that of the *BGB*. Hence, we will find most of the rules concerning the formation of contracts in Book I of the Civil Code. Book II, which covers the law of obligations, is composed of a general part, setting forth the rules regulating the contents and effects of contracts, followed by a second part, dedicated to the most common types of contract.

Examining the contents of Books I and II, however, we find that, here and there, the source of inspiration can rather be traced to the Italian Civil Code of 1942 or, perhaps to a lesser extent, to the *Code Napoléon*, the influence of which is clear in the first Portuguese Civil Code of 1867.

It is important to note that, once again reflecting the influence of the German *BGB*, we find most general rules concerning the life of a

contract to be drafted so as to apply to the entire law of obligations, whereas, in an even greater exercise of abstraction, the rules concerning the formation of contracts are to apply to any one or two-sided legal transaction. Indeed, with the exception of a relatively short section of the Code, which focuses on the contract as a source of obligations, only those rules regulating the most common contract types are wholly contained within the boundaries of the law of contract.

Specific types of contract are also regulated elsewhere – in other codes and statutes. Thus, for instance, some commercial contracts are regulated in the Commercial Code of 1888 and the labour contract is now regulated in the Labour Code of 2004. Significant rules of general contract law can also be found in non-codified statutes, the most important being those on standard terms and contracts of adhesion and on the sale of consumer goods and associated guarantees.

Legislation is not the only recognized source of law in Portugal. In fact usages are also relevant in a number of aspects of contract law, as are the codes of conduct in force amongst the members of certain professions.

Finally, even though formally they do not constitute binding sources of legal rules, a word should be said about the importance of case law and of legal writing – both national and foreign – in the interpretation and application of contract law.

2. Concept and general principles

We may define a contract as an agreement, formed by two or more parties, whose declarations to one another are able to generate for such parties legal effects of any nature – obligational or otherwise – that accord with the meaning of that agreement.

The most basic principle of Portuguese contract law is that of freedom of contract. The notion that, within the limits set forth in the law, parties may freely shape the contents of a contract is expressly contained in the Civil Code. Freedom to enter into a contract is implied throughout its provisions.

Another basic principle that permeates contract law is that of good faith. According to this principle, when making a contract, and later on, when performing that contract, the parties must comply with the requirements of good faith. As such, this principle is generally laid down in the Civil Code. However, these requirements, whilst stemming from an objective notion of good faith, are not directly set forth in any legislative source, but have rather been extensively elaborated in legal literature of Italian and mostly German influence.

The principle of good faith has also played a vital role in the shaping of the rules that regulate the consequences of a change of circumstances, and of the rules applicable to the abuse (or misuse) of rights.

3. Form and formation

Freedom of form is the default rule that is applicable to the making of a contract. Notwithstanding, certain types of contract such as the insurance contract are required to be drawn up in writing, whilst others must be executed by way of a public deed, as is the case with contracts for the sale or other disposition of an interest in immovable property. A contract that lacks the required form will be null and void; form is thus more than the prescribed way of evidencing the existence and contents of a contract, insofar as it is a precondition to a contract's validity.

Traditionally, a contract is said to have been concluded when a clear, sufficiently defined and firm or unequivocal offer is matched by a firm or unequivocal acceptance thereof. This model underlies the rules on formation set forth in the Civil Code. Nonetheless, there are numerous contracts in existence that contain no separate identifiable offer and acceptance, without any difficulties being raised in the application of those rules to the facts of a case.

As a general rule, contracts will become effective between the parties thereto as soon as they have been entered into.

For instance, in a contract for the sale of goods, unless the parties determine otherwise, the transfer of property will take place immediately upon conclusion. Should such transfer be subject to registration, however, it will only be enforceable vis-à-vis third par-

ties once the transfer is registered. The parties may determine that property over the goods sold will be transferred only at a specified later date. Or they may choose to conclude a preliminary contract (*contrato-promessa*) whereby they exchange promises to enter into a contract for the sale of goods. This latter type of contract is most commonly employed when the promised contract is subject to a heavy requirement of form – such as in the case of the sale of an interest in land. The preliminary contract is a general feature of Portuguese contract law: contracting parties may exchange promises to enter into virtually any other type of contract.

Some contracts will only become effective between parties thereto once the respective object has physically or symbolically exchanged hands. Such is the case with loan contracts, regardless of whether the loan involves a sum of money or other fungible goods or the gratuitous loan of a specific thing, and such is also the case with the verbal gift contract.

It is important to note that under Portuguese contract law the negotiating parties may be subject to pre-contractual liability (*culpa in contrahendo*) prior to conclusion of the contract. This will be the case if they do not comply with the requirements of good faith in the process of their negotiations or when breaking off such negotiations.

4. Representation

A person may be validly and effectively bound to a contract that another person has entered into, acting in the former person's name. If that agent has been granted the authority to act in the name of the principal then no further action will be required in order for the contract to bind the principal. If that agent acts without the necessary authority to represent the principal, or acts outside the scope of that authority, the latter must then ratify the contract in order for it to have binding effect.

As a general rule, the granting of the authority to represent the principal in the making of a contract is subject to the same requirement of form as that applicable to the contract under consideration.

Where an agent acts upon instructions and on behalf of the principal, but not in the principal's name, or where an agent does not reveal that it is acting as someone else's agent, only the agent – not the principal – will be directly bound to the contract concluded with a third party. However, the principal has a duty vis-à-vis its agent to take on all the obligations undertaken by the agent when carrying out the principal's instructions or, should such an assignment be impossible, to provide the agent with the necessary means with which to fulfil its obligations.

5. Validity

When a contract is invalid, depending on the failing that renders it invalid, it may either become null and void, in which case it will not produce its typical effect, or may rather merely become voidable, in which case it will be treated as valid and effective until actually avoided.

Any interested party may invoke the nullity of a contract, at any time, and a court of law may declare a contract null and void *ex officio*. Conversely, a contract may only be avoided by the party in whose interest the voidability is legally prescribed, and only within a year as from the date the failing has ceased to exist, unless the contract has not yet been fulfilled, in which case it may be avoided at any time.

The party that is entitled to avoid a contract may choose to confirm its validity, expressly or implicitly, provided that the failing has ceased to exist and that it is aware both of the failing and of its right to avoid the contract.

Both the avoidance and confirmation of a contract are retro-active, as is the declaration that a contract is null and void. Consequently, once a contract is avoided or declared null and void, the parties thereto must concurrently make restitution of whatever each one has supplied to the other under the contract, or an equivalent monetary value in case restitution in kind is not possible. Such retro-active force may not, however, injure the rights of *bona fide* third parties who have onerously acquired an interest in immovable property or in registered chattels.

Partial invalidity will not entail that the whole contract is rendered invalid, unless it is reasonable to conclude that the contract would not have been entered into without the affected part. For instance, pursuant to the statute on general contract terms and contracts of adhesion, in contracts not individually negotiated by the parties, clauses contrary to good faith will be null and void, however in most cases the remainder of the contract will not be affected by such partial invalidity.

A contract that has been declared null and void, or which has been avoided, may be converted into a different kind of contract, which would be considered valid under the circumstances if the purpose of the parties when entering into the first contract would allow one to suppose that this is what they would have wanted to happen had they foreseen the invalidity.

A contract is said to be null and void if performance of the contracted obligation is impossible at the time the contract has been concluded. A contract is null and void if it lacks the required form. A simulated transaction is also null and void. However, when the parties have concluded a simulated contract, but meant to agree to a different set of terms, their true agreement will prevail, notwithstanding the nullity of the simulated contract. Such nullity is not effective in dealings with *bona fide* third parties.

A contract whose object is indeterminable, contrary to mandatory legal provisions, or physically or legally impossible to fulfil, will be null and void. A contract whose object is contrary to public policy or morality (*boni mores*) will also be null and void. If, however, only the contract's purpose is contrary to mandatory legal provisions or to public policy, or offensive of morality, it will only be null and void if such purpose was common to the parties thereto.

On the contrary, a contract will be voidable if it was entered into by a person lacking the necessary capacity to act as signatory. It will be voidable when one of the parties has been led to conclude it by another party's fraudulent misrepresentation or non-disclosure of information, by illicit threats from or usurious practice on the part of the other party, provided that such practice enables it to obtain excessive or unjustified benefits. However, in the latter case, the contract may also be modified *ex aequo et bono*.

A mistake as to the identity of the other party or as to the object of the contract makes it voidable, provided that, at the time of contracting, the other party knew or ought to have known that their identity or the object of the contract constituted essential information to the mistaken party, so that, had the truth been known, no contract would have been concluded, or it would have been entered into on substantially different terms. A mistake concerning other motives also renders the contract voidable, but only if all contracting parties had recognized such motives to be essential to the contract. A mistake as to the circumstances that make up the basis of the agreement will be given the same treatment as a fundamental change of circumstances taking place after its inception (see below).

6. Contents and effects

The contents of a contract should be interpreted objectively, that is to say, a statement will be interpreted to have the meaning that would be accorded to it by a reasonable person in the position of the addressee, save if the person making that statement could not reasonably have anticipated such meaning. In the latter case, one may conclude that in fact no agreement has been reached, or if it can be established that the addressee was aware that the person making that statement intended it to have a particular meaning, such meaning will prevail.

Where the meaning of a statement gives rise to doubt, the meaning that should prevail is that which is less prejudicial to the disposing party, in the case of gratuitous contracts, and that which entails the greatest balance between the parties' undertakings, in the case of onerous contracts.

Contract terms should be interpreted within the context of the whole contract. Where doubt arises as to the precise meaning of a specific contractual term not individually negotiated, the meaning that should take preference is that which is most favourable to the party who has not supplied it. In any case, terms that are the result of individual negotiation prevail over those that are not.

A contract term may be express or implied. Implied terms are said to be those that can be derived without doubt from indirect demonstrations of the intention of the parties. Silence may only be interpreted to amount to an indirect demonstration of intention, and hence as a contractual statement, in those cases where such value is attributed thereto by a statutory or contractual provision or by any applicable usages.

A contract term that has not been subject to individual negotiation is deemed to be excluded from a contract when: it is not adequately communicated to the adhering party before the contract is entered into; it is not sufficiently explained to the adhering party; due to its graphic layout, its heading, or the context in which it appears, it would not have been apparent to an average contracting party; or, when it is inserted in a form after the signature of any of the contracting parties.

A party will not cease to be bound to carry out its contractual obligations simply because performance has become more onerous than expected. If, however, the circumstances upon which the parties have founded their decision to conclude their contract have suffered a fundamental (abnormal) change, and the risk of such occurrence was not one that, according to the contract, the party affected should be required to bear, so that to require performance would gravely affect the requirements of good faith, then the affected party is entitled to have the contract modified *ex aequo et bono* or, alternatively, to rescind it, unless the other party opposes such rescission but accepts the modification, in which case the latter will take preference over rescission.

A third party may require performance of a contractual obligation when its right to do so has been agreed upon by the contracting parties. However, the existence of such a right is not implied in every case that a third party will directly or indirectly benefit from the performance of a contractual obligation; intention to confer a true right upon the third party is required. The third party may choose either to accept that right or to renounce it. Acceptance must be notified to both contracting parties, whilst renunciation need only be notified to the promisor. The promise is freely revocable by the contracting parties at any time until the third party has expressed its

acceptance thereto, or at any time until the promisee has died, in the case of a promise that is to be fulfilled posthumously.

7. Performance, non-performance and remedies

Unless otherwise agreed by the parties, performance of a contractual obligation may be carried out by the debtor or by a third party, regardless of whether that third party has an interest in performance. As a general rule, performance must be tendered to the creditor.

Unless the parties agree otherwise, the place of performance of a contractual obligation to pay money is the place where the creditor has its domicile at the time of performance. The place of performance of a contractual obligation to deliver a given chattel is the place where it was located at the time when the contract was concluded. The place of performance of any other contractual obligation is the place where the debtor has its domicile when performance is due.

A contractual obligation must be performed at the time or within the period of time fixed in the contract. Where none has been fixed, the creditor may require performance at any time, and the debtor may perform at any time. If a period of time has been fixed, it will be deemed as fixed for the benefit of the debtor, in the sense that the debtor may waive that benefit and perform its contractual obligation at an earlier time.

Where the debtor is bound to perform several obligations of the same kind to the same creditor and the performance tendered is not sufficient to discharge all such obligations, it is for the debtor to designate to which obligations its performance is to be appropriated. If no such designation is made at the time of performance, it will be appropriated to the obligation that is due. If several are due, appropriation will be made to that obligation for which the creditor has the least security, thereafter to that which is the most burdensome for the debtor, then to that which was the first to fall due, and finally to that which arose at an earlier date. If none of these criteria applies, performance will be appropriated proportionately between all obligations.

Performance of a contractual obligation gives the debtor the right to demand that the creditor acknowledges its receipt thereof.

Non-performance of a contractual obligation will be excused if performance becomes impossible for reasons that do not result from the debtor's fault. An impediment to perform will discharge the debtor unless it is only temporary and the creditor's interest in performance is unaffected by the delay. If performance becomes partially impossible the debtor will be discharged by performing its obligation to the fullest extent possible, unless the creditor's interest in performance is justifiably lost. The creditor's contractual obligations will be proportionately reduced where only partial performance is rendered.

When non-performance of a contractual obligation is not excused, the aggrieved party may resort to one or more of the remedies set out in the law. Different remedies may be accumulated, provided that they are not incompatible. For instance, a party is not deprived of a right to damages by exercising its right to any other remedy, although in the case of accumulating damages with termination the applicable criteria and measure of damages is the subject of debate in case law and legal literature.

A person bound by a synallagmatic contract is entitled to withhold performance of its contractual obligations until the other party effects counter-performance, unless the contract requires the former party to perform first.

However, first and foremost, pursuant to the general principle laid down in the Civil Code, the aggrieved party is entitled judicially to enforce its rights under the contract and demand performance.

Where the obligation involves payment of a sum of money or delivery of goods, performance of such obligation will be enforced. Where the obligation involves an action to be taken and that action may be taken by a third party without injury to the creditor, performance of such obligation by a third party will take place at the expense of the non-performing party. Where the obligation involves an undertaking not to take some action, the result of such action will be destroyed at the expense of the non-performing party. Where the obligation involves entering into a contract, the judgment will take the place of the non-performing party's contracting statement. Lastly, where the obligation involves the taking of some action that may not be taken by a third party without injury to the creditor, the non-performing party may be sentenced to the payment of a daily sum of money until that action is effectively taken.

Specific performance is not always available to the aggrieved party. Destruction of the result of an action carried out in breach of contract will not take place if the non-performing party would suffer a considerably more significant loss from such destruction than that already suffered by the aggrieved party. An obligation to enter into a contract other than a contract for the onerous transfer or constitution of an interest in a building or in part thereof will not be enforced if the parties have provided otherwise in their agreement. An obligation to take some action that may not be taken by a third party will not be enforced where such obligation requires the non-performing party to possess special scientific or artistic qualities.

The aggrieved party may choose to terminate the contract if the non-performance is serious and definitive. A minor defect, or a simple delay in performance, is not an accepted ground for termination. In the case of delay, the aggrieved party will be entitled to terminate the contract only if it has justifiably lost interest in performance, or if it has given notice to the defaulting party of an additional period of time within which performance could still be carried out, after such period of time has elapsed. Similarly, if partial performance has been tendered, the aggrieved party may terminate the entire contract only if it has no interest in partial performance.

Notwithstanding the absence of an express legal provision to that effect, an abundance of case law has recognized that the aggrieved party may terminate the contract even before performance by the defaulting party becomes due, if the defaulting party has expressly or implicitly declared an intention not to perform.

Termination is excluded if the party purporting to terminate the contract is solely or overwhelmingly responsible for the other party's non-performance or if a circumstance for which the other party is not responsible materializes at a time when the former is in default through non-acceptance.

Termination of the contract releases both parties from their obligations to effect and to receive future performance, and it will have retroactive effect from the date of the contract's conclusion unless this contradicts the intention of the parties or the purpose of the termination.

Although consensus is far from being reached in this matter, an increasing number of authors argue that termination should not be retroactive in those cases where the purpose of the termination is not to put the aggrieved party as closely as possible into the position in which it would have been had the contract never been concluded, but rather to put the aggrieved party as closely as possible into the position in which it would have been had the contract been fully and properly performed, except that the aggrieved party has justifiably chosen to contract a third party to continue where the defaulting party has left off.

If the aggrieved party is unable to make restitution of whatever it has received under the contract, it will not be entitled to terminate the contract – but only, so one could argue, to the extent that the purpose of such termination would call for its retroactiveness.

As a general rule, a party's right to terminate the contract must be exercised by notice to the other party.

A party that accepts a tender of defective or partial performance is entitled to a reduction in price. Such reduction will be proportionate to the decrease in the value of the performance.

Finally, according to the general principle set forth in the Civil Code, the party who unjustifiably fails either to perform its contractual obligations, performs defectively, or performs at a later time than that which has been originally fixed, will be liable for all the loss caused to the other party, unless it is able to prove that it was not at fault in doing so.

The general measure of damages is an amount that will put the aggrieved party as nearly as possible into the position which it would have been in had the contract been fully and properly performed. However, if the aggrieved party chooses a remedy which is incompatible with such measure of damages, a different measure will be applied, namely reparation that will put the aggrieved party as closely as possible into the position in which it would have been had the contract never been concluded. In either case, such damages should cover both the loss that the aggrieved party has suffered and the gain of which it has been deprived.

Notwithstanding the above, the general principle laid down in the law is that the aggrieved party will only be paid a sum of money if it is impossible, inadequate or too burdensome for the non-per-

forming party actually to put the aggrieved party as closely as possible into the position in which it would have been had the contract been fully and properly performed, or had the contract never been concluded, as natural reconstitution will take preference over pecuniary compensation. In practice, however, a sum of money will usually be awarded to the aggrieved party, such general principle being interpreted to mean that when calculating such sum of money the cost of cure will take preference over the loss of value. But this will not always be the case. Also in line with such general principle is the rule that the aggrieved party is entitled to require from the supplier of defective goods that they be repaired or replaced by goods that conform to the contract.

The non-performing party will not be liable for the loss suffered by the aggrieved party to the extent that the latter contributed to the occurrence or escalation of its own loss.

8. Continuity and change

For the most part, Portuguese rules on contract law have passed through different political and economic periods relatively unscathed. The current Civil Code was approved under an authoritarian regime, which supported a protected economy, but its underlying principles on contract law are not so different from the liberal principles upon which the Civil Code of 1867 had been constructed. Those rules were even adapted to serve as the legal framework of the open and competitive European market.

Change and modernization are nonetheless both necessary and inevitable, and they have indeed already begun to take place under the influence of European law, particularly in the areas of consumer protection, competition and the power of regulatory authorities. Moreover, some aspects of non-performance require simplification and modernization, following the guidelines set out by the European Principles on Contract Law.

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